Not To Be Published:

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF IOWA
WESTERN DIVISION

SIOUXLAND ENERGY AND LIVESTOCK COOPERATIVE, Plaintiff, vs. MICHAEL GAYLOR AND GAYLOR ENGINEERING, Defendants.	No. C02-4033-MWB **MEMORANDUM OPINION AND ORDER REGARDING DEFENDANTS' MOTION TO DISMISS COUNT III OF PLAINTIFF'S AMENDED AND PROPOSED SECOND AMENDED AND SUBSTITUTED COMPLAINTS**

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I. INTRODUCTION AND BACKGROUND

As this court has observed on at least one prior occasion, the issue of pleading fraud with particularity is no stranger to commercial litigation despite the

efforts of this court and the Eighth Circuit Court of Appeals to clarify the requirements for pleading fraud. *Seaboard Farms, Inc. v. Pork Data, Inc.*, No. C00-4031-MWB, 2000 WL 33915815, *1 (N.D. Iowa Dec. 11, 2000). Now before the court is defendants' Michael Gaylor and Gaylor Engineering (collectively "Gaylor") August 12, 2002 motion to dismiss Count III of plaintiff's Siouxland Energy and Livestock Cooperative ("Siouxland") Amended Complaint (#5). Gaylor contends that Siouxland has failed to plead fraud pursuant to Iowa common law with the "particularity" required by FED. R. CIV. P. 9(b). Siouxland resisted this motion, arguing that the court should deny Gaylor's motion and both grant Siouxland's Motion for Leave to File Amended Complaint and Resistance to Defendants' Motion to Dismiss (#15 & 20) and afford Siouxland the opportunity to file its proposed substituted second amended complaint (#26) because the litigation is still in its infancy and Gaylor cannot legitimately contend that it will be prejudiced. Pl.'s Memorandum in Support of Motion for Leave to Substitute, at 1.

On April 24, 2002, Siouxland brought suit against defendant Michael Gaylor in Iowa District Court alleging that it suffered compensatory, consequential and incidental damages as a result of Michael Gaylor's negligent and fraudulent misrepresentations and professional negligence. On May 13, 2002 Michael Gaylor removed the case to federal court based on diversity jurisdiction. Thereafter, Siouxland amended its complaint to add Gaylor Engineering as a defendant and defendants "Gaylor" filed an answer to Siouxland's amended complaint, counterclaimed against Siouxland and filed a motion to dismiss, presently before the court.

The remainder of the procedural history in this case is characterized by ample motion practice, particularly on the part of Siouxland. To begin, Siouxland resisted Gaylor's motion to dismiss by filing a Resistance and its first Motion for Leave to File Amended Complaint (#13) on August 30, 2002. Attached to the motion was Siouxland's proposed second amended complaint. United States Magistrate Judge Paul A. Zoss denied without

prejudice Siouxland's motion for failure to comply with Local Rule 7.1(k). On September 11, 2002, Siouxland sought leave of the court for a second time to file its same proposed second amended complaint and resistance as it was previously submitted to the court (#15). Again, United States Magistrate Judge Zoss denied the motion without prejudice for failure of Siouxland to comply with Local Rule 7.1(k). For a third time, Siouxland sought leave of the court to file a second amended complaint and resistance to Gaylor's motion to dismiss on September 30, 2002 (#20).

On October 15, 2002 Gaylor filed a resistance to Siouxland's motion for leave to amend and declined to reply to Siouxland's resistance to Gaylor's motion to dismiss. Rather, Gaylor regarded Siouxland's failure to "challenge either the grounds supporting Gaylor's motion to dismiss or the law supporting it," coupled with Siouxland's request to file a second amended complaint, as conceding the accuracy of Gaylor's motion to dismiss. Def.'s Resistance to Pl.'s Third Mot. for Leave to Am. Compl. and Resistance to Mot. to Dismiss, at 2-3. Then, according to Siouxland, in an attempt to address Gaylors' disputes with Siouxland's proposed second amended complaint and without conceding that Gaylors' claims are correct, Siouxland proceeded to file a Motion for Leave to Substitute the attached second amended complaint (#26) for the one previously filed with its motion for leave to amend (#20). In addition, Siouxland filed its reply to Gaylor's resistance to Siouxland's motion for leave to file a second amended complaint (#28). On November 22, 2002, Gaylor filed a Resistance to Plaintiff's Motion for Leave to Substitute (#32). Thus, the court will address Gaylors' motion to dismiss, Siouxland's motion to file a second amended complaint, and Siouxland's motion for leave to file its proposed substituted second amended complaint.

II. LEGAL ANALYSIS

A. Standards For Motions To Dismiss

Federal Rule of Civil Procedure 12(b)(6) authorizes the district courts to dismiss any complaint which fails "to state a claim upon which relief can be granted." Fed. R. Civ. P. 12(b)(6). Rule 12(b)(6) affords a defendant an opportunity to test whether, as a matter of law, the plaintiff is entitled to legal relief even if everything alleged in the complaint is true. Under this standard, a complaint should be dismissed only where it appears that the plaintiff can prove no set of facts in support of its claim which would entitle it to relief. *Hishon v. King & Spalding*, 467 U.S. 69, 73 (1984); *Knapp v. Hanson*, 183 F.3d 786, 788 (8th Cir. 1999) ("A motion to dismiss should be granted only if 'it appears beyond doubt that the plaintiff can prove no set of facts which would entitle him to relief.'") (quoting *Morton v. Becker*, 793 F.2d 185, 187 (8th Cir. 1986), and citing *Conley v. Gibson*, 355 U.S. 41, 45- 46 (1957)). In applying this standard, the court must presume all factual allegations in the complaint as true and draw all reasonable inferences in favor of the non-moving party. *E.g.*, *Whitmore v. Harrington*, 204 F.3d 784, 784 (8th Cir. 2000); *accord Cruz v. Beto*, 405 U.S. 319, 322 (1972); *Anderson v. Franklin County, Mo.*, 192 F.3d 1125, 1131 (8th Cir. 1999); *Gross v. Weber*, 186 F.3d 1089, 1090 (8th Cir. 1999); *Midwestern Mach., Inc. v. Northwest Airlines, Inc.*, 167 F.3d 439, 441 (8th Cir. 1999); *Valiant- Bey v. Morris*, 829 F.2d 1441, 1443 (8th Cir. 1987). The court need not, however, accord the presumption of truthfulness to any legal conclusions, opinions or deductions, even if they are couched as factual allegations. *Silver v. H & R Block, Inc.*, 105 F.3d 394, 397 (8th Cir. 1997) (citing *In re Syntex Corp. Securities Lit.*, 95 F.3d 922, 926 (9th Cir. 1996)); *Westcott v. City of Omaha*, 901 F.2d 1486, 1488 (8th Cir. 1990) (the court "do[es] not, however, blindly accept the legal conclusions drawn by the pleader from the facts," citing *Morgan v. Church's Fried Chicken*, 829 F.2d 10, 12 (6th Cir. 1987), and 5 Charles A. Wright et al., Federal Practice And Procedure § 1357, at 595-97 (1969)); *see also LRL Props. v. Portage Metro Hous.*

Auth., 55 F.3d 1097, 1103 (6th Cir. 1995) (the court "need not accept as true legal conclusions or unwarranted factual inferences," quoting *Morgan*, 829 F.2d at 12).

B. Requirements For Pleading Fraud

A federal court sitting in diversity applies the applicable state substantive law, in this case Iowa law. Under Iowa law, to establish a claim for fraudulent misrepresentation, a plaintiff must prove: "(1) defendant made a representation to the plaintiff, (2) the representation was false, (3) the representation was material, 4) the defendant knew the representation was false, (5) the defendant intended to deceive the plaintiff, (6) the plaintiff acted in reliance on the truth of the representation and was justified in relying on the representation, (7) the representation was a proximate cause of plaintiff's damages, and (8) the amount of damages." *Schaller Tel. Co. v. Golden Sky Sys., Inc.*, 298 F.3d 736, 745-46 (8th Cir. 2002) (citing *Gibson v. ITT Hartford Ins. Co.*, 621 N.W.2d 388, 400 (Iowa 2001)). Because the proceedings are generally governed by the Federal Rules of Civil Procedure where there is no conflict with the state procedure, *Roberts v. Francis*, 128 F.3d 647, 650-51 (8th Cir. 1997) (citing *Hanna v. Plumer*, 380 U.S. 460, 465 (1965), the court is obliged to determine whether Siouxland sufficiently pleaded fraud with particularity under Federal Rule of Civil Procedure 9(b), thereby entitling Siouxland to a trial on the merits.

This court has articulated the elements of fraud under Iowa law and the standards for pleading fraud with the particularity required by FED. R. CIV. P. 9(b) in several recent decisions. *See Wright v. Brooke Group, Ltd.*, 114 F. Supp. 2d 797, 832-33 (N.D. Iowa 2000); *Doe v. Hartz*, 52 F. Supp. 2d 1027, 1055 (N.D. Iowa 1999) (elements and pleading); *Brown v. North Cent. F.S., Inc.*, 987 F. Supp. 1150, 1155-57 (N.D. Iowa 1997) (pleading); *Brown v. North Cent. F.S., Inc.*, 173 F.R.D. 658, 664-65 (N.D. Iowa 1997) (pleading); *Tralon Corp. v. Cedarapids, Inc.*, 966 F. Supp. 812 (N.D. Iowa 1997) (elements); *North Cent. F.S., Inc. v. Brown*, 951 F. Supp. 1383, 1407-08 (N.D. Iowa 1996) (pleading); *Jones*

Distrib. Co. v. White Consol. Indus., Inc., 943 F. Supp. 1445, 1469 (N.D. Iowa 1996) (elements of fraud and fraudulent non-disclosure); *De Witt v. Firstar Corp.*, 879 F. Supp. 947, 970 (N.D. Iowa 1995) (elements and pleading). In *Wright*, 114 F. Supp. 2d at 832-33, this court discussed Rule 9(b) and its requirement that a plaintiff "allege with particularity the facts constituting the fraud.'" *See Brown*, 987 F. Supp. at 1155 (quoting *Independent Business Forms v. A-M Graphics*, 127 F.3d 698, 703 n.2 (8th Cir. 1997)). Thus, "'When pleading fraud, a plaintiff cannot simply make conclusory allegations.'" *Brown*, 987 F. Supp. at 1155 (quoting *Roberts v. Francis*, 128 F.3d 647, 651 (8th Cir. 1997)); *see Commercial Prop. Inv., Inc. v. Quality Inns Int'l, Inc.*, 61 F.3d 639 (8th Cir. 1995) (finding conclusory allegations insufficient because "one of the main purposes of the rule is to facilitate a defendant's ability to respond and to prepare a defense to charges of fraud," quoting *Greenwood v. Dittmer*, 776 F.2d 785, 789 (8th Cir. 1985)).

Furthermore, the Eighth Circuit Court of Appeals recently noted that this rule of pleading is to be interpreted "'in harmony with the principles of notice pleading.'" *Schaller Tel. Co.*, 298 F.3d at 746 (quoting *Abels v. Farmers Commodities Corp.*, 259 F.3d 910, 920 (8th Cir. 2001). That is, "Although a pleading alleging fraud need not provide anything more than notice of the claim, it must contain 'a higher degree of notice, enabling the defendant to respond specifically, at an early stage of the case, to potentially damaging allegations of immoral and criminal conduct.'" *Id.* (quoting *Abels*, 259 F.3d at 920). However, the Eighth Circuit Court of Appeals has also observed:

> Rule 9(b) requires that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." "'Circumstances' include such matters as the time, place and content of false representations, as well as the identity of the person making the misrepresentation and what was obtained or given up thereby." *Bennett v. Berg*, 685 F.2d 1053, 1062 (8th Cir. 1982), *adhered to on reh'g*, 710 F.2d 1361 (8th Cir.), *cert. denied*, 464 U.S. 1008, 104 S. Ct. 527, 78 L. Ed. 2d 710 (1983).

Commercial Prop. Inv., Inc., 61 F.3d at ; *see Schaller Tel. Co.*, 298 F.3d at 746; *Abels*, 259 F.3d at 920. In this legal analysis, the court will focus on one of the enumerated 'circumstances' in particular—the content of the alleged false representations so as to determine whether Siouxland has sufficiently pleaded falsity and knowledge thereof on the part of Gaylor. In light of the requirements imposed by Rule 9(b), this court has held that

> general averments of the defendants' knowledge of material falsity will not suffice. Consistent with FED. R. CIV. P. 9(b), the complaint must set forth specific facts that make it reasonable to believe that defendant[s] knew that a statement was materially false or misleading.

Waitt v. Speed Control, Inc., No. C-00-4060-MWB, 2002 WL 1711817, at 26 (N.D. Iowa, 2002); *Brown*, 987 F. Supp. at 1155 (quoting *Brown II*, 173 F.R.D. at 669 (quoting *Lucia v. Prospect St. High Income Portfolio, Inc.*, 36 F.3d 170, 174 (1st Cir. 1994), in turn quoting *Serabian v. Amoskeag Bank Shares, Inc.*, 24 F.d 357, 361 (1st Cir. 1994)) (citing *Brown I*, 951 F. Supp. at 1408 (quoting *De Wit v. Firstar Corp.*, 879 F. Supp. 947, 989-90 (N.D. Iowa 1995), in turn quoting *Lucia*, 36 F.3d at 174))). In addition, this court has found that the requirement that a fraud claim plead facts from which falsity and knowledge of falsity can reasonably be inferred is harmonious with the Eighth Circuit Court of Appeals's decision in *Parnes v. Gateway 2000, Inc.*, 122 F.3d 539, 550 (8th Cir. 1997), which compelled the complainant to "set forth the source of information and the reason for the belief" when the "allegations of fraud are explicitly or . . . implicitly based only on information and belief" as the court considers Siouxland's allegations to be. *Id.* (quoting *Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 878 (1st Cir. 1991)).

C. Application Of The Standards

Gaylor argues that Siouxland has failed to plead its fraud claims with sufficient particularity as required by Federal Rule of Civil Procedure 9(b), and thereby has failed to

state a claim upon which relief can be granted. Gaylor contends that the allegations of fraud are merely conclusory, and more akin to claims regarding the parties' contractual matters currently in dispute and evidenced by Siouxland's failure to describe the circumstances of the fraud, including time, place, and contents of the false representations, the identities of the person making the misrepresentations and the recipient(s), and what was obtained or given up as a result of the misrepresentations. Def.'s Br. in Support of Resistance to Pl.'s Third Mot. for Leave to Amend Compl., at 3. Moreover, and of particular concern to the court, are Gaylors' assertions that Siouxland failed to plead what was false about any particular representation, what facts it relied upon to establish that Gaylor intended to deceive Siouxland by making such representations, and the materiality of such representations. Def.'s Br. in Support of Mot. to Dismiss Count III of Pl.'s Am. Compl., at 3. In other words, Gaylor challenges the sufficiency of the fraud allegations on the ground that conclusory allegations of scienter are insufficient.

In contrast, Siouxland maintains that its fraudulent misrepresentation claim is sufficient under the standards of Rule 9(b). It urges the court to adopt a "common sense approach" as to whether the pleading is sufficient because Siouxland alleges Gaylor knows the nature of the claims against it, the time frame, the identity of the person making the misrepresentation—Michael Gaylor, and to whom the statements were made. Pl.'s Reply to Resistance to Mot. for Leave to File Am. Compl., at 2. On the other hand, as stated previously, Gaylor contends that Siouxland has effectively conceded the correctness of its motion to dismiss through its failure to "challenge either the grounds supporting Gaylor's motion to dismiss or the law supporting it," coupled with Siouxland's request to file a second amended complaint. Def.'s Resistance to Pl.'s Third Mot. for Leave to Amend Compl. and Resistance to Mot. to Dismiss, at 2-3. The court, therefore, will determine whether Siouxland has pleaded its fraud based claim with sufficient particularity in its proposed substituted second amended complaint.

Siouxland's proposed substituted complaint, rather than state specific facts supporting scienter, contains only the conclusory statements that "Said representations were false. . . . were made with the intent to deceive and to procure SELC's investment in the Project. . . . were material to SELC in its decisions related to the design and construction of the Project." Pl.'s Mot. for Leave to Substitute, at ¶¶ 25-27. In *Gunderson v. ADM Investor Services*, this court concluded that the plaintiff's Second Amended Complaint sufficiently identified "specific facts that make it reasonable to believe
that "ADM's [defendant's] agents knew that their statements were materially false or misleading." *Gunderson v. ADM Investor Servs.*, Nos. C96-3148-MWB & C96-3151-MWB, 2001 WL 624834, at *8 (N.D. Iowa Feb. 13, 2001). In reaching this conclusion, the court relied on the plaintiff's assertion of alleged facts that could have been reasonably believed to have been known to defendant's agents at the time the alleged misrepresentations were made from which defendant's agents would or should have known that the representations in question were false or misleading. *Id.* *8 (N.D. Iowa Feb. 13, 2001). In the present case, although Siouxland sets forth the contents of its allegations with a greater degree of specificity in its proposed substituted complaint, Siouxland fails to set forth facts known to Gaylor defendants or their agents, at the time the alleged misrepresentations were made which would indicate that Gaylor knew or should have known the disputed representations were false or misleading. However, paragraph 24(g) which reads:

> Gaylor and GE represented both orally and in writing that they would provide SELC accurate and up to date information on the Project's progress and budgetary issues when, in fact, Gaylor was conspiring early in the design and construction of the Project to deprive SELC of accurate information and was purportedly authorizing work above the Contract Price without authority or input from SELC.

Pl.'s Mot. for Leave to Substitute,¶ 24(g), depicts an isolated instance where Siouxland

sufficiently asserts facts that could reasonably be believed to have been known by Gaylor defendants to be false or misleading at the time they were made. Apart from this occurrence, Siouxland's proposed substituted complaint alleges elsewhere the following:

> 24(c) Gaylor and GE's [*sic*] represented orally that their design would be one of the most efficient in the industry with regard to utility consumption and feed stock yield;
> 24(d) Gaylor and GE represented both orally and in writing that they would select appropriate used equipment for the Project and would make sure said equipment was refurbished and reconditioned prior to inclusion in the Project;
> 24(e) Gaylor and GE's [*sic*] represented both orally and in writing that their design would incorporate a life expectancy of twenty years for new equipment and ten years for used equipment;
> 24(f) Gaylor and GE represented both orally and in writing that they would have a qualified construction coordinator at the Project during construction.

Pl.'s Mot. for Leave to Substitute, ¶¶ 24(c)-(f).

Therefore, the court concludes that paragraphs 24-27 of the complaint do not adequately allege the scienter element of fraud, or allege the "circumstances" in such a way that scienter can be inferred. *See Lucia,* 36 F.3d at 174 (quoting *Serabian*, 24 F.3d at 361); *see also North Cent. F.S., Inc. v. Brown*, 951 F. Supp. 1383, 1408 (N.D. Iowa 1996) (quoting *DeWit v. Firstar Corp.*, 879 F. Supp. 947, 989-90 (N.D. Iowa 1995), in turn quoting *Lucia,* 36 F.3d at 174). Instead, the court finds that the factual allegations Siouxland relies upon to establish a reasonable inference of scienter are merely allegations of subsequent breaches of the promises they contend were made in the alleged misrepresentations. However, these allegations of broken promises neither meet the requirements for pleading fraud in accordance with FED. R. CIV. P. 9(b) nor are broken promises generally actionable as fraud. *Brown*, 987 F. Supp. at 1159 (citing *e.g. Northwest Airlines, Inc.*, 111 F.3d 1386, 1392 (8th Cir. 1997); *International Travel Arrangers v. NWA,*

Inc., 991 F.2d 1389, 1402 (8th Cir. 1993); *Coenco Inc. v. Coenco Sales, Inc.*, 940 F.2d 1176, 1178 (8th Cir. 1991). This court in *Brown* noted that the plaintiffs could plead the exception to the generally recognized rule concerning broken promises and satisfy the requirements of Rule 9(b) if the plaintiffs alleged,

> facts in the form of affirmative evidence from which it can reasonably be inferred that the Elevator could not or did not intend to perform its promises at the time the promises were made. Such facts would include . . . the defendant would have been unable to perform its promises or had already undertaken action that was inconsistent with its commitments, *see International Travel Arrangers*, 991 F.2d at 1403, or that the defendant was insolvent, knew that it could not perform the promises, repudiated the promises soon after they were made. . . .

Brown, 987 F. Supp. at 1159. Siouxland does not allege any such facts here.

Moreover, when the court looks to the substantive law of Iowa, which governs Siouxland's fraudulent misrepresentation claim, the court finds instructive the Iowa Supreme Court's decision in *Robinson v. Perpetual Services Corp.*, 412 N.W.2d 562, 565 (Iowa 1987) (citations omitted), which recognized under Iowa law that "a statement of intent to perform a future act is actionable if when made the speaker had an existing intention not to perform." The court was quick to point out that "in establishing the present intent not to perform, '[t]he fact the agreement was not performed does not alone prove the promissor did not intend keeping it when it was made.'" Similarly, "[a] contract claim cannot be converted into a fraud claim, even when there is a bad faith breach of the contract." *Northwest Airlines, Inc.*, 111 F.3d at 1393. Thus, simply because Gaylor allegedly did not comply with or failed to perform according to the terms of the parties' contract, does not alone give rise to an inference that Gaylor had an existing intention not to perform when Gaylor entered into the contract with Siouxland.

With regard to the remainder of Gaylors' contentions concerning whether Siouxland

sufficiently plead the time and place the fraudulent misrepresentations were made and by whom, the court finds that Siouxland's proposed second amended complaint plead wide time frames during which representations were allegedly made without indicating both the speaker and where the allegations were made. In its proposed substituted second amended complaint, Siouxland plead with greater specificity the identity of the speaker—Michael Gaylor, to whom he made the misrepresentations—SELC board members, and when—before Siouxland contracted with Gaylor and during the construction of the project. Pl.'s Mot. for Leave to Substitute, at ¶ 24. However, because Siouxland fails to sufficiently plead scienter and thereby does not set forth a fraudulent misrepresentation claim sufficient under the standards of Rule 9(b), the court does not decide whether Siouxland's proposed substituted second amended complaint remains deficient with regard to the allegations of time, place, and identity of the speaker.

III. CONCLUSION

Siouxland has had not one, not two, but three opportunities to amend its original complaint to comply with FED. R. CIV. P. 9(b) pleading requirements. Thus, much to the court's chagrin, and despite the fact that Siouxland does not adequately allege the scienter element of fraud, or allege the "circumstances" in such a way that scienter can be inferred, in the interest of justice, the court **denies without prejudice Gaylors' motion to dismiss,** and **grants Siouxland one final opportunity to amend its amended complaint**. In addition, or in the alternative, the court **denies Siouxland's Motion for Leave to File Amended Complaint** (#20) **and denies Siouxland's Motion for Leave to Substitute** (#26, 27) the proposed second amended complaint pursuant to Rule 15(a), because the proposed amendments are futile. *See, e.g.*, *Wiles v. Capitol Indemnity Corp.*, 280 F.3d 868, 871 (8th Cir. 2002) ("Leave to amend [pursuant to Rule 15(a)] should be denied if the proposed amended pleading would be futile"); *Grandson v. University of Minn.*, 272 F.3d 568, 575

(8th Cir. 2001) (same). This is so, because the fraudulent misrepresentation claim, even if amended and substituted as Siouxland proposes, would fail to satisfy the requirements of Rule 9(b), and therefore would not state a claim upon which relief can be granted. *See Dishman v. American General Assur. Co.*, 187 F. Supp. 2d 1073, 1093 (N.D. Iowa 2002). The court **grants Siouxland thirty days** to file an amendment to its amended complaint.

IT IS SO ORDERED.

DATED this 9th day of December, 2002.

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MARK W. BENNETT
CHIEF JUDGE, U. S. DISTRICT COURT
NORTHERN DISTRICT OF IOWA